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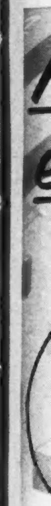

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The Canadian
Chartered Accountant

VOLUME 60 MAY 1952 NUMBER 5

COMMENT AND OPINION

C.I.C.A. Committee on the Companies Act

SINCE early last fall a special C.I.C.A. committee on the Canadian Companies Act headed by Mr. G. P. Keeping has been meeting bi-weekly (sometimes weekly) in Toronto to consider the recommendations to be made by this Institute to the Government of Canada for improving the statute and bringing it up to date, particularly as it affects the rights and duties of auditors and the contents of financial statements. The present Dominion Companies Act was passed in 1934 and, save for some amendments in 1935, the law as then enacted has remained unchanged all these years. Nobody will deny that the Dominion Companies Act is a remarkably fine piece of legislation, but it is also true that in the last decade and a half there have been important developments both in financial reporting and in the attitude of shareholders and the public generally to the contents of financial statements. The recommendations to be made by the C.I.C.A. Committee, which are expected to be elaborate, will, it may be assumed, suggest how the law may be amended to accord with today's requirements in these respects.

It is not known how soon a Bill will be introduced to Parliament for a revision of the present Companies Act, but it is becoming obvious that it will not be far in the future. The Dominion-Provincial Committee on Uniform Company Law last met in 1938 when it produced a draft of a new Companies Act, which, however, was not further proceeded with at that time, no doubt because of the outbreak of war soon afterward. It is understood that the Dominion-Provincial Committee is to be reconvened in the near future, and the recent announcement of the Ontario Government that it intends to introduce a Bill at the next session of the Legislature to revise the Ontario Companies Act makes the meeting of the Dominion-Provincial Committee more urgently desirable. It is recognized by everyone, and by none more than accountants, that a uniform company law for Dominion and Provinces alike is of the highest importance in this country of divided jurisdiction.

The C.I.C.A. committee on the Companies Act, now approaching the end of its labours, has had invaluable assistance in its task from the work of the C.I.C.A. Post-War Planning Committee which produced a report on the same subject in 1946, as well as from that of the Cohen Committee whose report was used as the basis for the new Companies Act enacted in Britain in 1948. The provincial Institutes have also been most helpful. The report of the C.I.C.A. committee, when finally produced later this year, will be submitted to the Dominion Government, and it is hoped that the several provincial Institutes will adopt it for submission to the governments of their respective Provinces.

Revaluation of Fixed Assets

THE ACCOUNTANT of March 1st contains an excellent article entitled "Are The Figures Any Use?" by Mr. J. Clayton, A.C.A., and here is an excerpt, which our readers may find stimulating:

> Two leading British companies, Courtaulds Ltd. and Imperial Chemical Industries Ltd. have recently attempted to grapple with the financial problems associated with physical replacement of their fixed assets — but have apparently reached diametrically opposite conclusions! In the former case, the conclusion was that the sums written-off by way of depreciation were insufficient and must be augmented. In the latter case a revaluation of the fixed assets "freed" the depreciation provisions which had previously been made from revenue and permitted their transfer to capital reserves.

Canadian Delegates to the London Congress

NEARLY a score of Canadian chartered accountants have already indicated their intention of attending the Sixth International Congress on Accounting to be held in London from June 16 to June 20 this year. The delegation will be headed by Mr. A. E. Beauvais, president of the Canadian Institute of Chartered Accountants, and Mr. King, secretary and research director of the Canadian Institute, will also attend. Others planning to attend are Mr. Richard C. Field of Victoria, a past president of the C.I.C.A.; Messrs. F. J. Grover, C. W. Mavor, and Paul Rising, all of Vancouver; Mr. G. W. Benson of London, Ontario, and Messrs. H. E. Crate, A. D. Downie, T. A. M. Hutchison, W. L. L. McDonald, F. A. R. MacFadden, and J. J. Shulman, all of Toronto; Mr. T. V. Burke, Lt.-Col. G. S. Currie, and Mr. D. H. M. Farish from Montreal.

Two members of the Canadian Institute have prepared papers for the Congress. Mr. J. R. M. Wilson, F.C.A., of Toronto, has submitted a commentary on the subject "Accounting Requirements for Issues of Capital: a Canadian Viewpoint", and Mr. C. L. King, F.C.A., has written a commentary on the subject "The Accountant in Practice: a Canadian Viewpoint".

Tax Pyramiding: Fact or Fiction?

By R. L. B. Joynt, C.A.

An investigation into the spiralling of taxes and a suggested remedy

"TAX increases must be passed on to the consumer, but why should they double in the process? Why should the retailer make a profit on the tax? There should be a law!" Sounds familiar, doesn't it? Even the Minister of Finance has intimated that there is something undesirable, something improper, something objectionable about this pyramiding of taxes.

Spiralling Taxes

Let us investigate further into this spiralling of taxes. The president of the Royal Bank of Canada referred to this same problem in the address to the Bank's shareholders. Taxes levied at the manufacturing level, he stated, are passed on plus mark-up, and eventually concealed in the retail price. This system is inefficient for it takes more out of the consumer's pocket than it yields to the Government in revenue. Worse still, it was stated, the purchaser does not see the increase as a tax but as a rise in the cost of living — a reason for demanding higher wages for his work or a higher price for his product.

A recent Canadian Chamber of Commerce News Letter reproduces a *New Yorker Magazine* cartoon which aptly expresses a similar view. It depicts union-management negotiators, with the union requesting "an escalator clause to meet any cost-of-living increase that may result from the granting of our wage demands".

The situation seems very simple: it is undesirable that taxes be increased in the process of distribution. The Government seems to be collecting less tax than is paid by the consumer; the consumer pays more tax than the Government added, or intended to add. Who is the culprit? What new control should be invoked?

How It Works

Let us set up a simple distribution process. The manufacturer, *M* Company, produces article *A* — any article of the hundreds used in our day-to-day living — which is subject to 25% excise tax. Obviously this type of article would also pay the 10% sales tax. Although this is a branded line, there are several lines on the market and competition is keen. Direct labor and materials show a unit cost of $1.00 for *A*. From experence, *M* Company knows that it must watch its costs and its markets carefully, knows that an increase in price reduces

demand and a decrease increases demand. *M* Company also knows its fixed charges will amount to $40,000 per annum, or 40c per unit on average plant capacity of 100,000 units per year. The manufacturer, *M* Company, decides, on the basis of its costs, to offer *A* for sale at $1.60. If it operates at 100,000 units it will show a profit on sales of 12½% — in actual practice, it would probably be closer to 5%.

Our wholesaler, *W* Company, now arrives on the scene in search of just such a product as *A*. *W* Company provides warehousing service, and has a staff of salesmen calling regularly on the retail trade. If *W* Company were not in business, *M* Company would need a much larger sales staff and would require regional warehouses with the necessary clerical staff. *M* Company is quite satisfied with this arrangement as it reduces its selling and warehouse expense. At the same time, *M* Company is paid for its goods before most retailers receive them, with much less credit risk.

W Company is quite satisfied with the unit price of $1.60 for *A*, except that 10% sales and 25% excise taxes must be added. The price has now jumped to $2.16. The manufacturer, *M* Company, merely turns over the 56c tax to the Government, and that is the end — or is it? *W* Company now must make a decision on its selling price. Its total expenses last year were aproximately $25,000 on a sales volume of $120,000; it must have a mark-up of 25% on sales to end the year in the "black". Article *A*, on this basis, costing $2.16, will then sell for $2.88. The retailer, Mr. *R*, accepts this price of $2.88 as his cost and sets the selling price to the consumer. His expenses, before salary, amount to $12,000; therefore, on sales of $45,000 he must have a mark-up of 33 1/3% to provide even a small salary for himself. The price to the consumer is now $4.32.

How It Could Work

May we take the same circumstances, except that we collect for the Government directly from the consumer, instead of from the manufacturer. The wholesaler, *W* Company, pays $1.60 and adds 25% mark-up (on sales). Mr. *R*, the retailer, now is able to purchase this same article for only $2.14 and sell it for $3.20, plus tax. The consumer pays $3.76 ($3.20 plus 56c tax), a saving of 56c over the previous price of $4.32. (Refer to schedule on p. 175).

Fantastic? Ridiculous? Not at all. The wholesaler, *W Company*, has an outlay in cash of $1.60, instead of $2.16. Whether this cash represents labour, materials, or taxes, makes no difference to *W Company* — it is all cash outlay. In any case, the wholesaler has a sizeable saving in interest charges and capital employed. It also has every opportunity of increasing volume on the lower price. Even in a better position is Mr. *R*, the retailer, who pays $2.13, instead of $2.88 for article *A*. The retailer's problem is one of turnover, and article *A* represents money which cannot be used for any other purpose for weeks, possibly months. But he has been able to reduce his selling price by 56c. He may well expect to increase his turnover, and his profit, so that eventually he can make further reductions in the price.

Just a Little Waiting

How is all this possible? Simply by asking Mr. *B*, the Federal Government, to wait a few weeks for his money. Mr. *B* at present steps in at the first stage for his cut. No waiting for him — let *M* Company absorb the tax involved in bad debts, or let the insurance company pay the tax on goods damaged in transit. Mr. *B* won't reduce his cut. Let *W*

Company finance the next stage (Mr. *B* needs, or is in a position to take, his cut on the ground floor). Any goods that are soiled or shopworn, any goods that are out of style, any bad debts, all these, including taxes paid by *W* Company — Mr. *B* is very hard of hearing! The next step is the hardest and longest. Poor Mr. *R*! Suppose that there has just been an increase in taxes, but because he has a stock on hand, Mr. *R* decides to maintain the old price. Because of this, his stock soon is depleted, and new stock is ordered at the new prices. What explanations he now must make! Why does his price increase more than the tax received by the Government — why is he taking a profit on the tax? But the worst is yet to come.

Let us now say (this is entirely fictitious, of course) that the tax is reduced. The day the Budget speech announces the tax decrease, Mr. *R*'s customers demand the article at the reduced price. But he cannot afford to reduce his prices until he purchases new stock at lower cost, but *W* Company will not reduce its price until it buys new stock from *M* Company. Nonsense! Mr. *R* reduces his price that first day, so does *W* Company. They just grin and bear it — they simply would not make a sale if they didn't. And Mr. *B* is really having a chuckle about the whole thing — he has his money, so why worry.

Advance Notice of Tax Changes

But even Governments can feel a sense of injustice. A recent news report mentioned the probability that tax reductions or increases would be announced to become effective *at some future date,* say three weeks or 30 days. Well, *W* Company and Mr. *R* have always taken a beating from Mr. *B* when tax reductions come along. This is just a new version, although it looks as if *M* Company is drawn into the melee. If the article which is granted the tax reduction is not an essential (and there are no excise taxes on bread and milk) then would it not be simpler and more direct to order *M* Company and *W* Company and Mr. *R* to close down for the 30 days? It would seem hardly worth keeping open for those hardy souls who enjoy paying higher prices that the Government has announced will be reduced in 30 days.

Possibly the Government, by advance notice, plans to take the gamble out of tax changes. Did we say "gamble"? But the Government disapproves of most forms of gambling — unless Mr. *B* gets his cut. It seems, in this case, that Mr. *B* is missing the boat. Almost a year after the sharp increase in excise taxes, advertisements still offer refrigerators or automobiles, and many less expensive items, at prices well below other dealers. Why? It is no secret. This retailer or that wholesaler was shrewd enough (or a good enough gambler) to stock up on such items and pay the lesser excise tax last April before the tax increase. Is this really gambling or is it legitimate? Although there is some risk involved if a tax is reduced, it would seem like a sure thing when taxes are going up. If the tax does not go up, simply return the goods for credit. If it does go up, you have an unearned profit at the expense of the Government.

Gambling or Shrewd Business Judgment

There is another way this "gambling" — pardon us, "shrewd business forecasting" — can work. This is a specialty line, produced by two large manufacturers and several smaller ones. One of the large manufacturers, with ample production capacity and financial backing, simply flooded his wholesalers before the tax increase. Yes, the manufacturer had to finance the tax, but look at

the competitive advantage he gained over his smaller competitors. First, the small fellow did not have the capacity to take the risk; second, the financing of the tax was out of the question (especially with bank credit as tight as it is): and third, it was not a sound business practice for a small concern. The actual situation is, that eight months later the product of the large manufacturer is still being sold well under current replacement prices. In this case, the large manufacturer, by his gamble, has greatly improved his position. To the consumer, the price has not advanced as rapidly; to the retailer, a larger profit on the increased volume of a quality product at a price below the prevailing market; to the wholesaler, an unearned profit by increased prices or larger volume.

What can the small manufacturer do? An appeal to the Government is useless, since the procedure is, without a doubt, fit and proper under present conditions. It seems that he must grin and bear it, unless . . .

And the Consumer?

Remember the saving the consumer makes if the Government collects the tax on article *A* at point of sale. The small manufacturer would be protected by this method, as the consumer is now the one who guesses on tax changes. With the tax at point of sale, the consumer pays the increased price (that is, the increased tax) the day it becomes effective. The consumer sees the increased tax, he can check its amount against the Government proclamation. The retailer stops being a cheat and a fraud, he is merely a collection agency for the Government. The tax gamble is eliminated for the manufacturer, the wholesaler, and the retailer. Production can now be planned by the manufacturer on a sounder basis with steadier employment.

Tax pyramiding — fact or fiction? Yes, it is a fact. Is it desirable? Emphatically *no.* Is it necessary? Under our present system of taxing, it is not only necessary, it is inevitable. But — *is it really necessary?*

SCHEDULE

(referred to on page 172)

COMPARATIVE CONSUMER COSTS BASED ON SOURCE OF TAX COLLECTION

		Taxes Collected By Manufacturer	Taxes Collected By Retailer
	Per Unit		
Manufacturer	—Total cost	$1.40	$1.40
	Gross profit	.20	.20
	Selling price	1.60	1.60
	Sales tax 10%	.16	—
	Excise tax 25%	.40	—
Wholesaler	—Total cost	2.16	1.60
	Mark-up 25% on sales to cover all expenses and profit	.72	.53
Retailer	—Total cost	2.88	2.13
	Mark-up 33 1/3% on sales to cover all expenses, owner salary and profit	1.44	1.07
Consumer	—Total cost — including indirect taxes	4.32	
	Retail sales price		3.20
	Sales tax 5%	—	.16
	Excise tax 12½%	—	.40
	Total Cost — including direct taxes		3.76
	Cash *savings* to consumer		.56
		$4.32	$4.32

Auditing For Parliament

By Watson Sellar, C.M.G., C.A.
Auditor-General of Canada

"Figures don't mean a thing unless you know what is behind them"

PUBLIC administration is complex and ponderous and, like all large organizations, bedevilled by a mass of paper-work, with every transaction regulated by Act of Parliament, regulation, or constitutional usage. J. P. Morgan once left a congressional committee room muttering that politicians expect bankers to have glass pockets, but that is the practice in governmental accounting, with every transaction open to scrutiny. Moreover, it is Canadian practice to encourage, in fact to expect, that those who enter the Civil Service will make it their life work; therefore, by regulations, rules, and procedures the aim is to safeguard against blunders being made which necessitate dismissals, and this of course, adds to the paper-work.

Checks and Balances

Public administration pivots on the use of checks and balances within organizations. One safeguard imposed by Parliament in 1931 was to separate accounting and cheque issue from departmental control. Up until then payments were made by departmental bookkeeping units and abuses had developed. For example, in one department a situation existed where a particular vote was continuously so over-committed that suppliers took it for granted that they would not be paid for two years, and adjusted their prices accordingly. The change made in 1931 was to vest the exclusive power of cheque issue in a comptroller of the treasury, and make it mandatory that, before a department made a contract, it must secure a certificate from the comptroller that funds were available to pay the account when presented for payment. The comptroller keeps all expenditure accounts, and the volume of his activities may be illustrated by noting that in a normal year he issues over 35 million cheques.

The Treasury is in fact an independent internal audit before payment, and has materially reduced the post-audit work. The expenditures in 1932, for example, approximated $450 million and the Audit Office required a staff of 225. Last year, expenditures totalled $2,900 million, yet all examinations were made by an Audit Office staff of 170. It is not for me to extol the efficiency of the audit, but I do take some pride in the

An address to the Toronto chapter of The Institute of Internal Auditors, January 25, 1952

fact that the Audit Office of today is one division of the Civil Service which is smaller in numbers than it was before the war. It also demonstrates that an efficient internal audit safeguards against mistakes and reduces the post-audit work. Both mean savings to taxpayers.

Who Is the Receiver General?

Do you sometimes wonder who is the Receiver General of Canada? If so, you are in good company because periodically some Member of Parliament rises in the House to put that query to the Minister of Finance. Actually, it is part of the title of the Minister, and continuance of the words is a concession to ancient usage. The first legislation on the subject was during the reign of Henry VIII who, finding weddings expensive, ordered a check-up of his receivers general and discovered that some among them were using his tithes and levies to speculate in the wool market. To stop that, Parliament in 1542 imposed a monthly penalty of 20% on each pound collected but not accounted for within three months. The breed was slow in mending its ways for as late as 1810 Parliament added to existing penalties a direction that every delinquent collector "shall be sentenced to be transported beyond the sea".

In Canada, the first appointment was during the regime of Lord Dorchester. At that time, the cost of government was defrayed mainly from two sources: sales of Crown lands, and customs and money grants by the British Government. The Governor wished to employ a travelling inspector of accounts. Whitehall ruled that he should be selected by and report to London. Subsequent defalcations gradually brought the office under local supervision and by 1840 he was a recognized officer of the Crown enjoying Cabinet rank. The receiver general in Canada was therefore first an internal auditor, but ultimately the division between financial policy and administration was bridged by the creation of a Minister of Finance.

The Government's Budget

The starting point of a government budget is different from that of a business concern. Parliament first decides how much should be spent in a year, then considers ways and means to finance the cost, and, to make sure, adds a borrowing power to the *Appropriation Act*. Parliament takes less interest in the collecting process than in the spending of grants. It is ever curious about the application of votes, but leaves to the Courts the duty of protecting the citizen against illegal levies by the Crown.

Every estimates item is considered in the House of Commons, where any member may move that the amount be decreased; he cannot move that it be increased. As there are several hundred items, discussion is with respect to those which are, for one reason or another, of current interest to some member or party. The plan was devised in days when functions of government were related to the maintenance of law and order and stable public services. Today, public administration includes activities which are industrial or commercial in character. A typical illustration might be the Malton airport outside Toronto. Consequently, the current technique of crediting all commercial income to revenue and charging all outgo to consolidated revenue fund has the effect of inflating both receipts and disbursements without any real utility in determining what tax rates should be. For example, last year Post Office collected around $105,500,000 in the course of its operations and spent about $106,900,000 in carrying the mails. In other words, the net cost to the taxpayer was about $1,400,000, which is the figure of real concern to Parliament.

Why "Audit"?

Have you ever given thought to the reason why "audit" — a word bearing association with the sense of hearing — is used to describe examinations of accounts? The usage stems from the Poor Law of 1601 which directed church wardens and overseers annually "to yield up to two justices a true and perfect account of all moneys received". Few could read or write in those days, therefore it was an oral accounting made under oath with liability to imprisonment for perjury if a true story were not told. Thus, the first audits were in fact a hearing, and almost 150 years were to pass before it was required that the accounts be presented to the justices in writing, and 40 years more before it was stipulated that three persons, "respectable in character and fortune", with one at least able to read and write, make a physical inspection of accounts.

Until around 1850 there was no parliamentary audit of accounts in Canada and only since 1878 has an independent audit been required. A government audit is made, among other reasons, in order to bring to light cases where directions of Parliament have either not been observed or given novel application. Consequently, in the annual audit report all of the washing is put on the line. Some of it is small chaff, and inclusion carries the risk that there will be those who regard the auditor general as big only in small things. On the other hand, communications I receive indicate that many Canadians, bewildered by totals running into billions, find satisfaction and accept the accounts with greater confidence because the audit sifting is done with a fine mesh.

Publicity

A corporate auditor is surprised, perhaps distressed, if his report to shareholders is made the subject of publicity. The Canadian auditor general expects that his report will be bandied about in the newspapers, in the House of Commons and in the Public Accounts Committee. A shrewd observer of government in England once wrote that press publicity — good or critical — always caused flutterings in the dovecotes of Whitehall and was the best means to bring about reforms quickly. I agree. Canadian newspapers seek to be fair and to avoid being dull. Editors and their parliamentary correspondents are men who can be trusted and their aim is to be impartial in the handling of news. Moreover, the annual "trial by newspaper" affords departments a chance to state their side of the case, because what hindsight makes absurd may be not unreasonable when matched up with the situation which existed at the time the action was taken.

Many assume that the auditor general has a power to prohibit or disallow an expenditure, but that is not the case. He is directed to draw attention to any matter which in his opinion merits the consideration of Parliament. Therefore, his audit report is only a step in the parliamentary audit. It has still to be scrutinized and tested by the House and, in particular, by the Public Accounts Committee.

Some Observations on Parliamentarians

Having had repeated opportunities to observe the committee in action, I'm irritated when an office visitor derogatorily remarks that he had visited the House and noticed that over half the seats were empty, including that of his member. The fact is that during a session the average M.P. works longer and harder than most people. The majority are at their offices early in the morning to go through a mass of letters from constituents. Some will be complaints, with

writers expecting the member forthwith to see that they get what they want "or else". Others will indicate that a contribution or a prize is expected for some social or other activity. Then there will be those who, without any particular aptitude, consider themselves suited for various appointments or positions, or qualified to instruct the member how he should vote on some important question.

The member is not provided with a staff to brief him or do the routine chores. He has to do his own foot work, pay for his taxis, entertain constituents at his own expense, carry out research work respecting legislation, etc. Almost every morning he has committee meetings to attend and, later, the House. Sometimes committees sit morning, afternoon, and evening, and he has to decide whether he should be in the Commons chamber or a committee room. Listening to speeches grows monotonous; moreover there is Hansard; hence members often go to committee meetings where a private member has greater opportunity to participate actively. That is one reason why the House is often only partially filled. Along about 11 p.m. he is finished his day. That goes on week after week, exhausting alike in health, pocketbook, and faith in mankind. If he goes home at week-ends, much of his time is devoted to constituency, not personal business, and between sessions he is expected to dash to Ottawa whenever some constituent wants something from the Government.

I have a tremendous respect for the Canadian M.P. He seeks to be fair and at all times be a good citizen and representative. Because he is in the limelight, we are prone to think that Members of Parliament have a long public career. Statistics tell a different story. The present House has 262 members. Only 40 of the present membership were in it when war was declared in the fall of 1939. In fact, less than 130 of the present members can look back over a parliamentary experience of three years. The vicissitudes of politics end the parliamentary careers of some, but more generally the cost in health and money is what causes many to drop out. It is harder, naturally, on Cabinet Ministers. The Cabinet formed in 1945 consisted of 19 members, with 5 in their 40's and 9 in the 50's — a relatively young group. Ten are no longer Ministers, five having since died and a like number finding it prudent to withdraw from the responsibilities of office.

Mr. Robert Watson Sellar, C.M.G., C.A. was called to the Saskatchewan Bar in 1919 after serving in World War I. In 1930 he was appointed Assistant Deputy Minister of Finance and in 1932 he became Comptroller of the Treasury. Since 1940 he has been Auditor-General of Canada. He also serves as chairman of the Board of Auditors of the United Nations. He was made a Commander of the Order of St. Michael and St. George in 1947. He is a life member of the Saskatchewan Institute and an honorary member of the Ontario Institute.

Their Rewards

Sir Robert Borden was Prime Minister in 1920 when the salary rate of Ministers was increased to $10,000. He indicated that a strong case could be made for $15,000, but as the parliamentary tradition was not to regard public service as an office of profit, he recommended $10,000, with the expectation that within 20 years a further revision would be necessary. He did not stress the impact of income tax, for a man earning around $10,000 then paid around

$800 a year. More than 20 years have passed. The responsibilties and cost of office have multiplied, yet nothing has been done. Because action must originate with those who would benefit, parliamentarians are diffident in making changes in sessional indemnities and Ministers' salaries, but I honestly believe that the time has come when Canadians, in the interests of Canada, should insist that parliamentarians take suitable action to the end that any man with the necessary talent may enter and remain in Parliament.

I can look back over an Ottawa experience of more than 25 years. I have seen and participated in the evolution and expansion of government in directions which would have been regarded as revolutionary when I entered the public service. There are those who quite erroneously assume that departments of government are cluttered with "experts", each, as a writer once put it, "knowing so much about so little that he can neither be contradicted nor is worth contradicting". The real problem is the ever-expanding areas of public activity. The Parliament of Canada is the supreme body and it is our common duty to buttress its position. With problems so varied, we are taking risks when so many men have to withdraw early from public life because they cannot afford to pay the price of representing the electors.

Statistics Overdone

Your duty and mine is to sift for facts. Sometimes I wonder about the growing use of statistics in public and commercial life, because too often they are regarded as proving something, rather than as indicating a probability. Whenever one of my chaps produces a graph I think back to an experience when I was comptroller of the treasury and instructed to pass upon all applications for additional telephones. No yardstick was provided, so the telephone company agreed that the switchboard girls — it was before dial telephones — would make a listing of all incoming and outgoing calls over a two weeks' period. I studied the resulting statement and found that the average use was around 10 calls a day. The telephone company confirmed that the figure was in line with commercial use. I then showed the tabulation to the Minister of Finance who used it to point out how I should proceed: one phone with a single call a day should be transferred to an office where around 100 calls a day were recorded, etc. When he finished, I gathered up the papers and said that action would be taken as soon as I had his instructions in writing, because I did not feel I had the power to take the telephone away from the desk of the Chief Justice of Canada and place it in a Public Works office, particularly as the Department was considering taking out the existing telephone, which was used by men calling to inquire if there were any snow shovelling jobs. The Deputy Minister of that Department never hired anyone by telephone and thus was, in fact, losing the time of the clerk who handled the calls. The Minister looked at me and ended the interview with the truism, "Figures don't mean a thing unless you know what is behind them".

When all is said, perhaps that best defines the purpose of a public audit.

A Simplified Working Sheet For Solving Funds Statement Problems

By Robert H. Gregory, Ph.D., C.P.A.
Associate Professor of Accounting, University of Buffalo

The steps involved in preparing a simplified transactions working sheet

THE April, 1951 issue of *The Canadian Chartered Accountant* contained a letter from Mr. W. M. Karney who asked whether full marks could be obtained by means of a finished statement of source and application of funds supported by marginal notes attached to the original data. Specifically, Mr. Karney objected to the methods of preparing funds statements illustrated in most text books. The methods were, in his opinion, time-consuming and wholly unnecessary.

Professor J. E. Smyth, C.A., editor of the "Students' Department", pointed out, in reply to the inquiry, that some marks may be given solely for reorganizing the data as an approach to the solution required. Supporting details for the solution (whether formal working papers or marginal notes on the examination) should be given to the examiner. Most examiners, Professor Smyth continued, would question a final solution — especially if correct — without any explanation as to where the figures came from.

In several years of classroom teaching I have encountered the same reaction as Mr. Karney's. On one hand, students find that the conventional statement of funds working sheet is unnecessary for solving the simpler problems. On the other hand, they prefer a systematic plan rather than marginal notes for solving complex problems.

The conventional funds working sheet illustrated in most accounting text books requires about ten columns to show the differences between beginning and ending trial balances; to adjust, reverse, or reclassify certain changes; and to classify items as funds or working capital. The adjusting, reversing, or re-classifying entries are the chief stumbling block in using and understanding the funds working sheet. I submit the proposition that *there is no sound reason why the funds working sheet should use reversing entries.*

An Important Idea

There is an urgent need for a simplified working sheet for solving both simple and complex working fund problems in a minimum amount of time. The underlying idea of the working sheet presented here is that entries made on the working sheet should be essentially the same as were originally recorded in the formal books. This is an important idea. It deserves careful consideration because it eliminates the need for reversing or reclassifying entries. In es-

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STATEMENT OF FUNDS WORKING SHEET

December 31, 1948 — December 31, 1949

	Trial Balance December 31, 1948		Transactions		Trial Balance December 31, 1949	
Investment in stocks of subsidiary companies (at cost)	$ 350,000			(a) 110,000	$ 240,000	
Buildings and equipment less allowance for depreciation	800,000		(g3) 296,000	(g1) 12,000	1,020,000	
				(g2) 64,000		
Patents and goodwill	140,000			(b) 100,000	36,000	
				(c) 4,000		
4% mortgage bonds		500,000	(d) 100,000			$ 400,000
Preferred stock (par $25 each share convertible into two shares of common)		250,000	(e) 40,000			210,000
Common stock (par value $10)		300,000		(e) 32,000		432,000
				(f) 100,000		
Paid-in surplus		200,000		(e) 8,000		258,000
				(f) 50,000		
Earned Surplus		590,000	(b) 100,000	(a) 90,000		631,000
			(d) 3,500	(h) 107,900		
			(g1) 3,400			
			(i) 50,000			
Working Capital	550,000				635,000	
Reported income			(h) 107,900			
Patent write-off			(c) 4,000			
Depreciation of building and equipment			(g2) 64,000			
Sale of investment in subsidiary			(a) 200,000			
Purchase of bonds				(d) 103,500		
Sale of common stock			(f) 150,000			
Sale of equipment			(g1) 8,600			
Purchase of building				(g3) 296,000		
Dividends declared				(i) 50,000		
	1,840,000	1,840,000	1,127,400	1,127,400	1,931,000	1,931,000

Exhibit 1: A SIMPLIFIED WORKING SHEET FOR SOLVING FUNDS STATEMENT PROBLEMS

sence, the working sheet proposed here and shown in *Exhibit 1* is a transactions working sheet that brings together all desired information involving working capital. *Exhibit 1* illustrates the use of the working sheet proposed here as a solution to Question 5, Accounting II, Intermediate Examination, October, 1950, which appeared in *The Canadian Chartered Accountant,* October, 1951, (pp. 163-5). The solution accompanying the problem contained a statement of source and application of funds but did not contain a working sheet.

So much for the introductory remarks. Let us turn to the working sheet itself. The steps involved in constructing it are few and simple.

Prepare a six-column working sheet with two columns for the beginning trial balance, two for transactions, and two for the ending trial balance. Income and expense accounts in either trial balance are closed to the earned surplus account so that only balance sheet accounts are listed. The account titles may be listed in any order, but it is desirable to lump together all working capital accounts and put the initial and final net amounts at the end of the trial balances so that there will be ample space to enter the transactions involving working capital. The title "working capital" is substituted for individual current accounts when making journal entries on the working sheet.

Four Classes of Transactions

The transactions to be considered in preparing the working sheet can be divided into four classes depending on the nature of the accounts involved: (1) current accounts only; (2) income or expense accounts and net worth account; (3) current and non-current accounts; and (4) non-current accounts only.

Transactions that involved current accounts only are excluded from the working sheet because they did not cause any net change in working capital. An example of this type of transaction is the collection of accounts receivable or the charge-off of accounts receivable against the allowance for doubtful accounts. Whether such transactions occurred during the year or at the end of the year (by being stated in the facts of the problem), they are not entered on the working sheet.

Dr. Robert H. Gregory, Ph.D., C.P.A. is a member of both the Texas and Illinois Societies of Certified Public Accountants. He is an associate professor of Accounting and Finance at the University of Buffalo.

Transactions that involved income or expense accounts and net worth account, the second class of transactions, are entered on the working sheet by making an entry similar to that originally used to close the net profit or net loss (or individual income and expense accounts if detail is available and is desired on the working sheet) to earned surplus. The assumption is made, for the moment, that working capital is increased by the amount of net profit or decreased by the amount of net loss. The result of this entry is to set up the net profit as a debit to working capital (or the net loss as a credit to working capital) and to show the effect of the profit or loss upon earned surplus.

The entry described above to record net profit as a debit to working capital and a credit to earned surplus represents the combined effect of two types of entries. The first type of entry reflected operations of the period. Income items were recorded as debits to working capital accounts and as credits to income accounts (or expense items as debits to expense accounts and as credits to work-

ing capital accounts). The second type of entry closed the income and expense accounts to the earned surplus account. If a profit resulted from operations, the net effect of these two types of entries was a debit to working capital and a credit to earned surplus.

The single entry required to show the effect of operations upon working capital is written as "h" (to identify it with the facts of the problem) on the working sheet in *Exhibit I* as follows:

(h) Working capital —		
Reported income	$107,900	
Earned surplus		$107,900
To set up effect of period's operations upon working capital.		

This and other entries need be written only on the working sheet; but they are written separately here for explanatory purposes. The preceding entry indicates that working capital was increased by the amount of operating profits. This amount will be adjusted, as explained below, to eliminate the effect of expenses (such as depreciation) and incomes that entered into the calculation of reported earnings without affecting the amount of working capital provided by operations.

Transactions that fall into the third class, those that involved working capital and non-current accounts, are entered on the working sheet in essentially the same manner that they were originally entered on the formal books. This category includes transactions involving changes in non-current assets (purchase or sale) or non-current equities (issuance or redemption of securities and declaration of cash dividends).

This category also includes expense and income items that did not involve changes in working capital. Such transactions must be entered in order to convert the net operating result set up by an earlier entry (entry "h" in this case) to the working capital basis. Examples of such transactions are depreciation of fixed assets, amortization of bond discount or premium, and amortization of patents.

The transactions in the third category that are entered on the working sheet are (with the identifying letters shown in the problem) as follows:

(a) Working capital — Sale of investment in subsidiary	$200,000	
Investments in stock of subsidiary companies (at cost)		$110,000
Earned surplus		90,000
To enter the working capital obtained from sale of investment in subsidiary.		
(c) Working capital — Patent write-off	4,000	
Patents and goodwill		4,000
To adjust the amount of working capital set up by entry (h) for the amount of patent amortization included.		
(d) 4% mortgage bonds	100,000	
Earned surplus	3,500	
Working capital — Purchase of bonds		103,500
To enter the application of working capital to acquisition of bonds at a premium.		
(f) Working capital — Sale of common stock	150,000	
Common stock (par value $10)		100,000
Paid-in surplus		50,000
To enter the working capital obtained from sale of common stock.		
(g^1) Working capital — Sale of equipment	8,600	
Earned surplus	3,400	

Buildings and equipment less allowance for depreciation		12,000
To enter the working capital obtained from sale of building and equipment.		
(g^2) Working capital — Depreciation of building and equipment	64,000	
Buildings and equipment less allowance for depreciation		64,000
To adjust the amount of working capital set up by entry (h) for the amount of depreciation expense included.		
(g^3) Buildings and equipment less allowance for depreciation	296,000	
Working capital — Purchase of building		296,000
To enter the application of working capital to purchase of equipment.		
(i) Earned surplus	50,000	
Working capital — Dividends declared		50,000
To enter the application of working capital to the declaration of dividends.		

Transactions falling into the fourth class, those that involved non-current accounts only, are entered on the working sheet in order to prove the arithmetical accuracy of each account on the working sheet and to disclose transactions that might otherwise be overlooked. Entries of this type in this problem are:—

(b) Earned surplus	$100,000	
Patents and goodwill		$100,000
To write off entire amount of goodwill.		
(c) Preferred stock	40,000	
Common stock		32,000
Paid-up surplus		8,000
To reflect decrease in preferred stock through exercise of the conversion privilege.		

Hidden Transactions

Each account on the working sheet should be proved horizontally in order to discover any hidden transactions that were not described in the facts of the problem. Such transactions fall into one of the four classes of transactions described above. Hidden transactions are entered on the working sheet in the fashion that will most logically explain what happened. Although there was no hidden transaction (both amounts and accounts) in this problem, an example would be a decrease in earned surplus and an increase in common stock not specifically explained by any of the facts. In such case, the most logical explanation would be that a common stock dividend was declared and issued. The transaction would be entered on the working sheet in the same way that it was originally entered:

Earned surplus	xxxx	
Common stock		xxxx
To reflect declaration and issuance of common stock dividend.		

A line-by-line proof of the working sheet might, for example, disclose an unexplained increase in fixed assets and decrease in working capital. A reasonable explanation of these two changes would be that fixed assets were purchased by payment of cash or by an increase in a current liability. This transaction would fall into the third class of transactions described above—one involving both current and non-current accounts. The following entry would be made on the working sheet:

Fixed assets	xxxx	
Working capital — Purchase of fixed assets		xxxx
To enter the application of working capital to purchase fixed assets.		

The statement of source and application of funds can be prepared directly from items listed in the transactions columns under working capital. The funds statement can be prepared as

shown on page 164 of the October 1951 issue of *The Canadian Chartered Accountant* in which the total sources of funds is equal to the total application of funds — sometimes called "balanced form". If desired, however, the funds statement can be prepared so that the net change in working capital is the remainder after subtracting applications from sources. This type of statement for the F Co. Ltd. is shown in *Exhibit 2.*

The funds statement shown in *Exhibit 2* eliminates the anomaly of listing a decrease in working capital as a source of funds which is done when the funds statement is prepared in balanced form.

The funds statement shown in *Exhibit 2* shows depreciation expense and patent write-off as additions to the funds obtained from operations. This procedure is necessary when the individual expense and income items are not available but are summarized into one net result. Nevertheless, a preferable plan (if the information is available) is to show only those income and expense items that involved changes in working capital. The effect of each income and expense item on working capital can be shown on the source and application of funds statement with a parenthetical explanation of depreciation and other non-working capital expenses. If desired, explanations of the adjustments from the income-expense basis to the funds basis can be omitted completely. Neither of these plans for showing more detail in the funds statement is feasible, however, unless the detailed information for items in the income statement is available.

The primary objective of this article is to show a simplified working sheet plan for quickly solving both simple and complex source and application of funds problems. The form of working sheet suggested in *Exhibit 1* and described in this article is easy for students to learn because it uses straight-forward entries instead of reversing entries. It enables a person to work a funds problem in less time than is required by conventional working sheets, T-accounts, or schedules. It is vastly superior to the haphazard plan of using marginal notes on the problem sheet itself.

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STATEMENT OF SOURCE AND APPLICATION OF FUNDS

for the year ended 31st December, 1949

Net profit for period		$107,900	
Add: Items not requiring outlay of funds			
Depreciation	$64,000		
Patent write-off	4,000	68,000	
			$175,900
Sale of X Co. Ltd. stock			200,000
Sale of 10,000 common shares at $15			150,000
Sale of equipment			8,600
			$534,500
Application of Funds			
To redeem bonds at 103½		103,500	
To pay dividends		50,000	
To purchase fixed assets		296,000	$449,500
Increase in working capital			$ 85,000

Exhibit 2: STATEMENT OF SOURCE AND APPLICATION OF FUNDS SHOWING THE INCREASE IN WORKING CAPITAL AS THE REMAINDER

System in a Chartered Accountant's Office

By Alexander M. Reid, C.A.

A practising C.A. outlines in detail a system suitable for a public accountant's office

1. Filing Systems

A filing system which I have found suitable for a small or medium-sized office of a practising chartered accountant is based on five separate sets of current files. These are all filed in steel filing cabinets, unless for working papers where the quantity is too great and some space-saving arrangement is used, such as floor to ceiling cupboards. The five sets of files are as follows:

1. correspondence;
2. tax;
3. partners' private and special files;
4. audit working papers;
5. bound office copies of financial statements and reports.

Correspondence and Tax Files
(Exhibit 1 — see p. 188)

Exhibit 1 shows a system of indexing for use on the correspondence and also on the clients' tax files. It may be noted that the first two letters of a client's name, followed by a number, represent the name of the client, while the following letter designates the different files for that client. The correspondence and the tax file may have the same index designation for any one client, but the file folders are distinguished by having tabs of a different colour, and the tabs are on a different side of the file folder — one on the right and the other on the left. These files may be kept together in the same filing cabinets, or in separate filing cabinets, according to one's preference.

In my opinion, this system provides a good measure of flexibility for the addition of new files from time to time, due to the use of the numbers, while preserving most of the advantages of a simple, alphabetical system by the use of the first two letters of the name of the client, which allows for a more or less alphabetical arrangement.

It should be a strict rule that all documents be filed tight in legal-size file folders by means of "acco" type fasteners. Double page tax returns may be slit down an inch or so from the top and folded over, to allow one to read them more easily when they are in the file.

Good, durable file dividers, preferably with tabs down one side only, make for greater efficiency in pulling and refiling the folders. All file folders should have stamped plainly on the outside the year date of documents filed therein.

An address to the B.C. Institute November 29, 1951

EXHIBIT 1

SUGGESTED CODE FOR INDEXING FILES
IN THE OFFICE OF A CHARTERED ACCOUNTANT

	Pink tabs on right corner of files		Blue tabs on left corner of files		
	General Correspondence file	Special subject file	T. 2. file	General Income Tax file	P.C. 2. file
Barrow Bros.	Ba-1			Ba-1	
D. L. Barrow	Ba-2			Ba-2	
F. W. Bartholomew	Ba.-3(a)	Ba-3(b)		Ba-3	
Bonnell Estate	Bo-1(a)	Bo-1(b)		Bo-1	
A. T. Thompson Ltd.	Th-1		Th-1(a)	Th-1(b)	
A. B. Turner	Tu-1			Tu-1	
Tudor Co. Ltd.	Tu-2(a)	Tu-2(b)	Tu-2(a)	Tu-2(b)	Tu-2(c)
Tucker's Ltd.	Tu-3		Tu-3(a)	Tu-3(b)	

Private and Special Files

For filing documents and letters relating to subjects designated by partners as private a separate system is recommended, so that the information contained in such a file may be kept confidential at all times. Folders in this system should be distinguished by having tabs of a colour different from the other files.

Security of Files

It is suggested that a master list of all files be maintained by the stenographic department, in order to exercise at least some control over office files.

Perhaps it is needless to say that all files in the office should be locked, so as to safeguard the information contained therein, and some reasonable precautions should be taken to protect them in case of fire.

Audit Working Papers Files

With regard to working papers files, whether they are secured by an "acco" type fastener or by a split pin in the upper left corner, they are certainly best filed tightly in stiff, durable covers. The practitioner should have his firm name and address printed on the cover, and information written or typed as to the name of the client, the period covered, and the names of the partner, manager and other audit seniors engaged on the assignment. I suggest that these files be arranged in strictly alphabetical order in the filing cabinets, and that clients' permanent files be filed with them, although being designated plainly as such, and preferably in distinctive durable covers.

Bound Office Copies of Financial Statements and Reports

For bound office copies of financial statements and reports, a separate set of filing cabinets may be used, in which the folders are filed in strictly alphabetical order, using good durable file dividers, with tabs all on the left side.

Covers for these folders should be a colour different from that of the folders issued, and have the words "Office copy" printed boldly on the outside, and provide on the inside for information as to the disposition of all copies which were issued.

Transfer of Files

It may be said that the high cost per square foot of office premises compels the practitioner to conserve space. Transferring files to less useful space helps achieve some space economy, and as well tends to effect greater efficiency in using the current files.

I would suggest a plan whereby the current files contain only about two years' accumulation of documents, and the transferred files contain the previous three years' accumulation, maintained on a system similar to that outlined for the current files. All files older than this could be transferred in the latter part of each year, before the more busy season commences in January.

I would suggest that audit working papers be put into manila folders for storage, which allow easy access, and the filing of future years' transfers, while still offering some protection against dust. These folders should be plainly labelled, noting contents, and be arranged in strictly alphabetical order on the shelves of the storage room.

Correspondence and tax files should be wrapped in convenient packages and labelled for storage, and a number given to each package.

A record of all files transferred to permanent storage should be made and copies kept in the office and in the storage room, and this will constitute an index for locating files required.

Bound office copies of financial statements could be kept in the current files for a longer period, perhaps 10 years.

2. Client Control Cards

(Exhibit 2 — see p. 190)

Exhibit 2 sets out a form of clients' control card for use in a visible index type loose leaf book. Such a card could be drawn up to suit any of the visible index types of systems, which are generally recommended for a record of this sort.

Mr. A. M. Reid, C.A. is a partner in the firm of Carter, Reid & Walden, Chartered Accountants, Vancouver. He was admitted to the B.C. Institute in 1943 and served on that Institute's Council for four consecutive terms from 1947 to 1951.

This form calls for certain information respecting clients' affairs which should concern the auditor. Its purpose is to furnish a reminder of work to be done by the auditor, and of the deadlines for completion of this work, so as to minimize the chance of missing a deadline, and to remind clients of returns they must file.

(Exhibit 3 — see p. 191)

The space on the card for each month in which a deadline occurs, or a financial period ends, should be coloured with a pencil or distinguished by a form of tab, so that one may readily see which clients require some attention according to the information on the cards. The secretary in charge of these records should go through the cards at the beginning of each month and list the clients' deadlines on a control form, as set out in Exhibit 3 (p. 191) showing the partner or manager normally in charge of each client's affairs.

(Exhibit 4 — see p. 191)

The items may then be re-listed on a separate work sheet for each manager, as set out in Exhibit 4 (p. 191).

With this schedule as a guide, he should be in a position to see that the work is done prior to the end of the month, and enter the filing dates on his schedule. In cases where the clients take responsibility for filing a return, someone may be instructed to notify them that such a return must be filed by the end of the month.

EXHIBIT 2

CLIENTS' CONTROL CARD

Address	Plant Address

Directors & Officers		Employees		Solicitor
Man. Dir		Off. Mgr.		Tfr. Agents
Pres.		Acc't.		Assoc. Co.'s
V. Pres.		Ass't. Acc't.		
Secty.		Cashier		
Treas.				Year End
		Sales Mgr.		Tax Returns
Partners		Prod. Mgr.		Partner in chge.
		Nature of Engagement		

Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.

Client's Name	File No.

EXHIBIT 3

FORM FOR RECORDING DEADLINES OR RETURNS DUE MONTHLY FROM CLIENTS' CONTROL CARDS

Prepared by: Cleared by: Date:

Client's Name	Partner in ch'ge	Year end	T.2 TP2	T1	T4	T5	609	UST 456	T7 T7B	Other	Remarks

EXHIBIT 4

FORM FOR TRANSCRIBING WORK OR DEADLINES EACH MONTH FOR ATTENTION OF EACH PARTNER OR MANAGER

Attention:

The following items require attention by:

Prepared by: Cleared by;

Client's Name	Year end	T.2 TP2	T1	T4	T5	609	UST 456	T7 T7B	Other	Date attended	Remarks

Where he has notice of the impending end of a financial period, the manager may proceed to dispose staff to carry out duties such as counting cash, observing inventories, or circularizing accounts receivable. When he has attended to all the items, the sheet is to be returned to the secretary for filing, or for carrying forward items not yet completed.

If considered necessary, the clients' control cards may form a basis for circulating to clients notices of information to be prepared for the auditors in advance of audit staff commencing their work, or of various tax returns or remittances to be filed.

They may be used also to help determine in advance what work must be accomplished in any period, so that a budget of staff time may be worked out with a minimum danger of overlooking any existing commitments.

The information on the card as to names of officers and employees should be of some use to the audit manager and the audit staff, especially where the audit staff changes.

It goes without saying that it is important to keep this information accurate and up to date.

With various refinements to suit particular needs, a system of control such as I have outlined should be of considerable benefit to the practitioner in operating his practice, especially if used conscientiously.

3. Billing Procedure

I would like to consider now a procedure used in connection with the billing of fee revenue, based on a system of standard rates, and designed to account in a positive manner for variances from the standards established. The method I have in mind can be operated easily, even where the practitioner prefers to account for revenue on a cash received basis, in which case memo accounts may be used for this purpose.

Let us assume that the practitioner has a system of employees' time records which calls for a periodic time summary for each employee, by client and by employee.

The summary of time by employee is posted in the employee's time ledger, showing productive normal time, productive overtime, non-productive time and time off. This record provides a means of remuneration for overtime if such is the custom in the office, and also sets out for management's consideration the proportions of non-productive time.

The summary of time of each employee for each client is posted to the client's time ledger, noting the employee's name, and the total of such time balanced with the total of productive time which was posted in the employees' time ledger.

(Exhibit 5 — see p. 193)

When a client is to be billed, a summary of time is made up on a charge summary form, as set out in Exhibit 5, classifying the time under the proper value categories, shown in sections one to seven on the left hand side of the form.

Value categories are determined by reference to a schedule established for this purpose, and based strictly on the range of wages of the employees. In establishing standard values, the same percentage factor is used to extend average wage costs within each range to an estimated standard sales value — say, for example, 250% of the average wage in each range. For a wage range of $1.00 to $1.20 per hour, which might average $1.10 per hour, extended at 250% would have a standard value of $2.75 per hour which might be classed as, say, category #5 for this purpose.

The total time in each category is then extended at the respective standard values on the right hand side of the charge summary, and totalled.

The partner then has some criterion to work from, which he may take into account together with all other pertinent factors, and may then determine the fee to be charged to his client. The amount of variance of this figure from standard may be entered on the charge summary, as a profit or loss.

If the amount billed is less than standard, the entry in his revenue journal, if revenue is accounted for on an accrual basis, would be:

Dr. Accounts receivable — with amount billed
Dr. Variance account — with amount of the loss
    Cr. Standard Fee Revenue — with the amount of the standard fee total.

The practitioner thus would have a formal record of the relative profitability of all engagements billed, which should prove a valuable guide for future management.

A running control of total unbilled time for all clients can be obtained if

total time added in the clients' time ledger is entered in a memo control record, and the total time billed monthly is subtracted from this account, leaving a balance which represents total hours of work unbilled.

EXHIBIT 5

CHARGE SUMMARY

Client:

Description of Work:

Period — From:
To:

Date Prepared

Partner O.K.

Time:							Disbursements			Calculation of Charges		
1	2	3	4	5	6	7	Description	Amount		1		
										2		
										3		
										4		
										5		
										6		
										7		
										Standard total		
										Profit — Loss		
										Total billed		

BILL

Recent Books

Elementary Accounting, by Perry Mason, George B. Stenberg, and William Niven; published by The Foundation Press, Brooklyn, 1951: pp. 653 and index; price $5.50 U.S.

When a new text appears which treads the beaten track of the introductory course in accounting one naturally is interested to discover in what respects, if any, the new work is unique. This book is noteworthy for a thoughtful introduction, an attempt to provide the student with an overall picture as rapidly as possible, and a separate, 275 page problem section.

The introductory chapter takes stock of the vocational opportunities for the accounting student and cannot fail to stimulate his interest. Appropriate emphasis is placed on the public accounting profession from the student's point of view. The authors then make use of the time-honoured theory of the balance sheet equation as a prelude to a rapid presentation of the complete accounting cycle.

Illustrations are good throughout except for an elaborate and dangerous segregation of "undeposited cash" from "cash in bank" calling for the use of both a cash disbursements journal and a cheque register; and except for the treatment (common to most United States authors) of the awkward T-account as the "standard" form. A commendable effort is made to provide a sufficent background of business forms and techniques to meet the needs of students at the elementary level. Unfortunately, many of the legal forms used as illustrations are applicable only to United States practice. Another common (but not serious) fault is the inclusion in an introductory text of material which might better have been demonstrated in a separate volume. This book includes in its 653 pages of text certain chapters which are normally beyond the scope of an introductory course.

The problem section, so necessary in a work of this sort, leaves nothing to be desired.

F. N. Beard, C.A.
University of Toronto

Hotel Accounts, by T. J. Barrett, F.A. C.C.A.; published by Gee and Co., London; pp. 83 plus many illustrations of the accounting forms referred to in text; price 17/6

Mr. Barrett has produced a handbook of accounting procedure applicable to small and medium-sized hotels. In his position of chief accountant of Grosvenor House, London, he is in a position to speak with authority on this subject. However, it should be borne in mind that because of the practical differences in bookkeeping and accounting routine in Canada, there are only certain chapters in the book which can be given critical consideration. His chapters on organization and system vary from Canadian practice slightly, although basic reasons for good record-keeping (e.g., need for speedy recording and prevention of pilferage and fraud) are, it would seem, universal. In reference to guest accounts, the arrival and departure book, the guests tabular ledger, and other

supporting records differ from the registration and account cards now in common use in Canadian hotels. No fault is inferred because of this difference in system, but the comparison becomes necessary when reading the book for practical accounting knowledge.

References to "Nationality Statistics" required in England were rather startling because of the complete absence of such information in Canada. Comment on the matter of depreciation, while outlined in accordance with sound accounting principles, brings to mind the current restrictions in this country on writing off the cost of new equipment, so frustrating to the hotel industry.

Chapters on the purchase journal and stock control are simplified and in keeping with the standard procedures. While no new ideas are set forth, the author has emphasized the importance of adequate control of supplies on hand and proper analysis of purchases.

This book is of academic interest to accountants concerned with the systems of small hotels. It is of little value to operators of large units. It adds to the woefully small number of writings on the subject, but unfortunately it is not an adequate reference book for the Canadian industry.

MORTON W. RASHKIS, C.A.

Preparation for Professional Examinations, by J. H. Burton; published by Gee & Co., London, 1952; pp. 91; price 10/

Although many of the ideas put forward in this book have been expounded by numerous authors, it is increasingly evident that further discussion is still worthwhile.

Mr. Burton has approached the problems of examination-writing not with the usual derogatory remarks about the examinations themselves but with sound constructive advice to those who are to sit for an examination.

The book is divided into three parts: (1) before the examination; (2) during the examination; (3) after the examination. In the first part, Mr. Burton suggests many excellent ideas concerning decision to qualify, value of examinations, exemptions from preliminary examination, membership in students' societies, methods of preparation, maintenance of health, and avoidance of brain fatigue. He makes it clear that "an examiner regards himself as an ally of the candidate, not an enemy. He is the guardian of that professional efficiency which is, surely, the student's aim." Candidates should realize that "questions are not traps. Each is set in to give an opportunity to the candidate to set forth his knowledge of the subjects of the examination."

In the second part, the author deals with examination room tactics, setting out therein some 42 "helpful hints" together with a few words to special types of students. This section could be put to use by every student who wishes to use his knowledge to the best advantage in the examination room.

In the third part, Mr. Burton gives advice not only to those who have been successful but also to those who have failed. "The path to success is the path of common sense, but hard work and determination are essential qualities of the traveller. Knowledge alone will not suffice. Application, industry, infinite patience, superb courage and an indomitable will are also necessary." This idea seems to have been lost in our modern society, and it is to his credit that he has come forward and expressed himself in such open terms.

All students will find this book is well worth the reading, and it is hoped that many of the suggestions expressed therein will be put into practice by

those who are preparing to enter a profession. In addition, there are numerous ideas in this volume which every professional man or woman might well take to heart and use to advantage.

GERTRUDE MULCAHY, C.A.
Toronto, Ontario

Changing Concepts of Business Income — Report of Study Group on Business Income; published by The Macmillan Co., New York, 1952; pp. 160; price $2.50

Many of us have long been looking forward to the publication of this report. Our interest has been stimulated by intermediate publications such as "Business Income and Price Levels—An Accounting Study", by George O. May (July 1949) and "Five Monographs on Business Income" by various members of the Study Group (July 1950). If practising accountants have not familiarized themselves with these and other already published materials, then they are surely failing to give proper consideration to problems which should be of vital concern to them. For they are specialists in accounts concerned pre-eminently with ensuring, to the best of their ability, that published accounts shall not mislead, and this places on them a great social responsibility.

It is therefore greatly to the credit of the American Institute of Accountants that, in 1947, it formed this study group to undertake a [1]"historical study of the uses of the word 'income' and terms associated therewith in accounting and in business, economic and political fields". It had the vision to seek and obtain a grant from the Rockefeller Foundation capping its own appropriation of $30,000, to make possible this investigation, and it appointed as general director and consultant of the study group an accountant with the outstanding reputation and experience of George O. May. The auguries were good. The results as now published may not be nearly as definite and far-reaching as some of us would have wished them to be, while to others they may seem to break altogether too freely with tradition. But what is important is that we now have a basis of agreement on the need for some reform, arrived at by the majority of members of an official committee appointed by a leading institute of professional accountants. If we add to this the announcement made recently[2] by a committee of the American Accounting Association, representing the academic accountants in the universities of the United States, then we have the considered opinions of two complementary bodies, both pointing in the direction of change.

It is important to note the limited objectives with which the study committee began its investigations. The published letter to the Rockefeller Foundation, referring to the significance of the word "income", suggested that "a fair measure of agreement could be reached as to the proper usage of the word when combined with a particular clarifying adjective". We cannot expect any detailed exposition of ways and means of implementing decisions taken by the committee, as to changes which may be required in the accountant's concept of business income. The ground to be explored is the field purportedly representing income, for the delimitation of new boundaries. As to how hitherto undeveloped ground taken over from capital may actually be marked off and the new boundaries determined in practice is beyond the scope of the survey. The committee's achievement is to be evaluated on the basis of its success or failure in arriving at some measure of agreement as to what *is* income. Once the profession as a whole makes up its mind as to this, then steps can be taken to experiment with methods of adjusting published accounts to reflect any change in the significance of the word. The study committee itself refers to the avowed reluctance of the British Tucker Committee, in 1951, to allow depreciation for income tax purposes on replacement values, even if it had had any inclination in that direction, when the profession itself was not willing to recognize this as a proper basis in the accounts. "The

[1] Extract from Exhibit 1, p. 140: a copy of letter to the Rockefeller Foundation.

[2] Price Level Changes and Financial Statements, Supplementary Statement No. 2, *Accounting Review*, October, 1951, p. 468.

use of this argument emphasizes the great social responsibilities of the accountant", says the present report (p. 56).

Before looking at the final summary of conclusions we may note some of the points made by the report. A brief mention is made of the all-important distinction between the meanings attached to the word "market" by the profession in North America and Britain, respectively, in the expression "cost or market", used in the valuation of inventories. "In England", says the report, "the reduction to market value is regarded as a provision for an anticipated loss made out of realized profits. In the U.S. the reduction is regarded as an element in determining profit." This results from the fact that Britain uses "market" to signify "selling price less selling expenses", while North America interprets it as "replacement price". In times of falling prices this might result in tremendous differences in the determination of income on the two sides of the Atlantic.

As is natural in the U.S., where LIFO is now legal for income tax purposes in almost any circumstances, the report gives careful consideration to the effect of LIFO on income calculation. It is pointed out that, as a result of recent extensions of usage, the amount charged against revenue under LIFO "may not be the cost of any goods actually purchased but may be determined by a price index" applied to dollar amounts of inventories. Consequently "the fiction that it is a cost method may have to be abandoned". The report points out the inconsistency of accepting such a concept of LIFO and rejecting charges for property exhaustion based on the current price level instead of historical cost. It is to be noted that the publication[3] of the American Accounting Association already referred to recommends that "the effects of price fluctuations upon financial reports should be measured in terms of the over-all purchasing power of the dollar — that is changes in the general price level as measured by a general price index". The study group also envisages the use of a general price index without further specification, "beyond stating that it ought to be based on the prices of a wide variety of goods and services, reasonably weighted". It emphasizes that "the choice of units of measurement seems to lie between monetary units of changing purchasing power and units of equal purchasing power", with the object of matching current costs against current revenues.

An important section of the report reviews in more or less detail various other new problems affecting income calculation to-day. It deals specifically with accelerated depreciation, lease-backs, pensions and the all-inclusive concept of income presentation. Large corporations such as United States Steel are using accelerated depreciation provision based on indices to permit heavier charges against income for exhaustion of facilities, in years when plant and machinery are being used above normal capacity. The report properly emphasizes that aggregate charges against revenue can, under this method, never exceed historical cost. Indeed U.S. Steel only reluctantly adopted the method in 1948, when forced by the Securities and Exchange Commission, with the concurrence of the American Institute, to reverse its practice, adopted in the previous year, of charging depreciation based on replacement costs.

Under lease-back agreements a new plant may be sold to, say, an insurance company, and leased back by the vendor for a number of years. This method of financing has assumed such large proportions in the U.S. that it has been made the subject of Research Bulletin No. 38 by the American Institute. The report stresses its significance "as an illustration of the tendency to create artificial contractual relations for the purpose of affecting determinations of income for tax or other purposes".

The pensions question is one of ever-growing importance to the accountancy profession. The main question is whether past-service pension provisions should be made out of current revenues. To indicate the magnitude of the problem the report quotes U.S. Steel's actuarially calculated liability of $574 million — about 50% of the market value of its preferred and common stock. A pertinent comparison is made when it is remarked that since accounts are normally drawn up on a going-concern basis, the absolute necessity for a double charge against revenues for past and current services may be called in question, as the reserve for past services "will

[3] *Ibid.* p. 471.

assume practical importance only in the event of abandonment". Nevertheless, the report regards as a practical solution the spreading of such charges over a period of future years, with full disclosure.

The committee compares income calculation based on the "purchasing power postulate", which would eliminate the effect of changing money values by the use of "some specified general index of prices", with the traditional "monetary postulate". It recognizes both postulates as fictions, but regards the acid test as one of usefulness. Since the purchasing power postulate takes into account, from one concern to another, variation in the importance of physical assets, in their rate of turnover and in their average age, all of which are ignored by the monetary postulate, the former is preferred. It is considered that misallocation of investment resources is likely to be greater on the traditional basis, with resulting excessive stimulation of business in times of rising prices.

The positive conclusions of the group, pointing in the direction of change, are summarized as follows. (1) In the long run (obviously this qualification is added as a compromise) it should be possible to frame published accounts which will show separately (a) profits or losses on the assumption of stable money values and (b) those resulting from changes in such values. (2) The problems of presentation should not be beyond solution by to-day's highly developed accounting techniques. (3) While for the present it may be well for the primary statements of income to be made on traditional bases, corporations with widely distributed ownership should give supplementary information enabling income to be determined in units of approximately equal purchasing power. Here an important conclusion, opposed to that of the American Accounting Association which might have been expected to be the less practical of the two, is that this additional information should, wherever practicable, be given "as part of the material upon which the independent accountant expresses his opinion". While managements must still accept responsibility for choosing from various accepted methods, the independent accountant must assume in regard to the supplementary information a similar responsibility to that accepted for the traditional accounts. The advantage of marketability sought for securities brings with it an obligation to make proper disclosure to investors generally.

Put baldly in this way the various recommendations may seem strangely over-cautious and we may well agree with George O. May and Oswald Knauth when they comment that "modifications in an effort to reconcile conflicting views have resulted in some loss of incisiveness in the conclusions". They would have had the group make a specific recommendation, in the case of railways and regulated utilities, for mandatory provision for property exhaustion on the basis of current price levels. While several members expressed various dissents the chairman, Percival F. Brundage, would have had it go further in innovation. To some of us, at any rate, it is encouraging to find George O. May, foremost of American accountants, asking "why an accountant who claims, and is presumed, to be competent to pass upon the fairness of a purely subjective computation of a charge for accelerated depreciation, or of the application of LIFO accounting, on the basis of price indexes, should not be, or be expected to become, competent to pass also on the fairness of an application of a price index to a charge for exhaustion".

KENNETH F. BYRD, M.Sc. (Econ.), A.C.A.
McGill University

Cash

By John A. Cooper, C.A.

How we should count cash and why

I propose to elaborate on a few of the more important details of a count which we all at times tend to be lax on, and also go into a few of those things which, although not part of a count, surround it and play a very important part in its accuracy.

Time of Year to Count

We all realize that the cash should be verified at the end of the fiscal year to support the figure of cash on hand and in bank as an asset on the balance sheet. This does not mean that internal auditors have to verify it at that date, for often this is impossible when staff is limited and numerous counts and verifications must be made; also, external auditors play an important part in year-end verifications. I think it will suffice to say that counts of major importance should be verified at balance sheet date by internal or external auditors.

Time of Day to Count

Should we make our count in the morning before any business is transacted, during the day, at the close of the day, or at night when all persons responsible for the handling of cash are absent? If we make our count during the day, it interferes with daily routine. If we make it late at night without the presence of the cashier (but of course in the presence of a responsible official) we are often lacking vital information which only the cashier can give us. As for the other two possibilities, it's six of one and half a dozen of the other. In the morning, we have the advantage of being able to follow the cash and cheques to a deposit, and the deposit right to the bank. In the evening we have the advantage that the count will not interfere in any way with the business routine. The time of count will, of course, be largely dependent upon the surprise element. For instance if you arrived at a branch office in the late evening, your count should be made early next morning. If you arrived in the middle of the day, count the cash at the end of that day, *not* the following morning.

Surprise Element

Should the auditor forewarn those responsible for cash of our impending visit, or should he drop in out of a blue sky? If there is sufficient warning, a smart cashier who has been defrauding the company will be able to cover up the cash position in such a way that only

A paper read to a meeting of the Institute of Internal Auditors, Toronto, Dec. 14, 1951

an extended detailed audit will uncover the shortage. This is sometimes difficult, in that many companies have numerous branches or divisions, which make impossible a long extended audit at any one branch. Even a short warning will give a cashier time to cover up the shortage temporarily.

A cashier who, although honest, has made numerous errors in change, withdrawing funds, depositing etc., will also try to cover up these mistakes to safeguard his or her job. This type of situation, although usually discovered, makes a cash count very difficult.

Insufficient Staff

Occasionally there are numerous funds or the funds are so large and complex that it would be impossible to make a satisfactory count, reconciliation, and tie-in of all funds with the staff available without completely disrupting business for a considerable length of time. Should one use the assistance of the local talent and if so whom? In my opinion we should employ the help of those members of the staff who do not deal directly with the cash or cash transactions and if possible, non-accounting-minded personnel. If an accounting-minded individual has to be used, procure the assistance of the most responsible person in the unit, such as the branch manager, office manager, or department head.

More than One Unit in Same Area

What should be done when there are two or three branches, units, or divisions in the same city, within reasonable distance of each other, and there is not sufficient staff to handle all units at the same time? We can not lock up the funds of one while we count the next one, for that would disrupt business, nor can we safely count one and then proceed to the next and count it. The only solution I have found is to count the cash at all units in the normal manner, then where feasible make a surprise return from another city or position in the near future, and count it again at the #2 unit. The same treatment can later be applied to #3 unit.

Other Verification Assistance

I find that talking to the employees about their work, about specific accounts receivable that are past due, about certain policies and routines they follow, and by asking leading questions in a friendly sort of way, can often be of benefit. You quite often find that an employee who is conscientious, enjoys his work, and is doing his job in the best interests of the company is very willing to talk and holds nothing back. When an employee hedges and answers indirectly you will have been warned and should become very suspicious in your count.

From my own experience I have found that the verification of accounts receivable through confirmation letters has often brought to light accounts which have been paid, but the cashier had not deposited the funds.

Internal Control

From the standpoint of the internal auditor, more important than the cash count itself is his work throughout the year in setting up a proper system of internal control and the routing of employees' duties, so as to effect such control. We should try to prevent the disease first, instead of finding the ailment and then effecting a cure.

Important Points in Count

There are several items in the detail of a cash count which I consider to be very important:—

1. All funds, securities and negotiable instruments should be under control of the auditor at all times throughout

his count. This is to guard against the possibility of a shortage in one of these assets being covered up by temporarily converting other negotiable assets or withdrawing funds from the bank.

2. Always make the count in the presence of the custodian and have that custodian sign for receiving back funds, vouchers, etc., that have been counted and even when there are no funds to be counted, the custodian should sign to the effect that there were no funds.
3. A deposit slip should be made out at the time for all funds on hand for deposit, and someone should accompany the clerk taking the deposit to the bank. If the count is made at the close of business, please see that such funds and deposit slip are locked up for the night.
4. Cash should be counted and balanced as at the date accounts receivable balances are confirmed if it is the custom to verify accounts receivable.
5. Follow through carefully on any cheques, I.O.U.'s or advances that are included in the cash funds. At the time of count these should, of course, bear the approval of an authorized person.
6. The bank account should be reconciled if possible, as at the day of the count. If not feasible, scrutinize the current cheque stubs and reconcile the bank at the end of the month including the follow-up of the previous month and the current month's outstanding cheques.
7. All vouchers included in the count should be initialled by the auditor and subsequently followed through to the book of original entry.
8. Proof of count — ensure that you know what you are tying up your various funds with. For example, link cash sale receipts with undeposited cash sales, impress petty cash with authorized amount in the general ledger.
9. Even if there are no funds on hand, we still have a great deal of work to do to prove that such a situation should exist.

After spending two years as a pilot in the R.C.A.F. during the war, Mr. John A. Cooper became a registered student in accounting with Thorne, Mulholland, Howson & MacPherson, and later with Allen, Miles, Fox & Johnston, both of Toronto. He was admitted to the Ontario Institute in 1949 and at present is chief auditor of Hobbs Glass Limited, Toronto.

Naturally, the above points are only a few of the score of items that have to be closely watched in any count.

Why Cash?

Why do we count cash at all? I think I can even give a few reasons to back up this statement. Throughout the year, an internal auditor spends a great deal of our time in ensuring that a proper system of internal control is working. He would not expect to find the cash situation out of hand if he were to perform a count and he knows that at the end of the fiscal year the external auditors are going to count and verify the cash as being one of the assets on the balance sheet. Then too, his time is valuable and he should put his knowledge to the best use and it should be put to use in the important interest of the company. I was asked during the year why we bothered counting a few hundred or even a thousand dollars worth of cash in the office when there were thousands of dollars worth of inventory being shipped out the back door unnoticed. Naturally, this situation would

depend upon the particular business: the internal auditor cannot be every place at the same time. However, I do think that if he spends his time knowing all phases of the business, assisting the accounting staff, knowing the personnel both in the office and in the plant, raising the standards of accounting and control, keeping his eyes open for things behind the scenes and perhaps slightly out of his recognized jurisdiction, such as fire hazards, empty plant with door wide open, carelessness by employees of company property, damaged goods on which claims have not been filed and numerous others, I think he can do a better job for his company and be the means of saving a greater amount of money than can ever be accomplished by spending all his time counting the cash.

Letters from Readers

Request for a Formula

February 12, 1952

Sir: Would any of your readers be able to give a formula which would produce the same final figure after commencing two problems with an identical amount of profits, but from the first amount deducting commission payable, then from the balance of taxable profits deducting tax and so arriving at the first answer; secondly, from the second amount deducting the tax payable, then on the balance calculate the commission payable, and so arrive at the second answer which is the same as that in the first problem? For example,—

Profits	$600
Less Commission	57
	$543
Less Tax Payable	24
	$519

Profits	$600
Less Tax Payable	24
	$576
Less 10% Commission	57
	$519

A complication arises in that the rate of commission is known, 10% on profits less tax, but the tax payable is not known until the commission is known.

W.E.L.

A Canadian Bankruptcy Institute

Montreal, March 22, 1952

Sir: A national Bankruptcy Institute ought to be formed in Canada with an office located in Ottawa or Toronto.

The prime purpose of the Institute should be to set up an educational standard for old and new licensed trustees in bankruptcy to the mutual advantage of bankrupts and creditors in Canada.

The Institute should encourage the universities in Canada to develop courses in bankruptcy law and accounting, and arrange for well-known practising licensed trustees to give lectures based on their practical experiences.

The Superintendent of Bankruptcy in Ottawa and the official receivers in each Province might also be asked to lecture from time to time on the mechanics of the Bankruptcy Act.

All the licensed trustees in Canada today should automatically become members of the Institute upon payment of a fee that would be sufficient to meet the cost of an office, a manager, a secretary, and other nominal expenses incidental to the running of such an Institute.

Some of the officers of the Canadian Institute of Chartered Accountants might be able to draw up a set of rules and regulations that would be necessary for controlling all the members of the Canadian Bankruptcy Institute.

Morris Goodman, C.A.

Professional Notes

C.I.C.A. President and Secretary Tour Western Institutes

Mr. A. Emile Beauvais, accompanied by Madame Beauvais and Mr. Clem King, C.I. C.A. Secretary and Research Director, visited the western Institutes in January and February. At each stopping point Mr. Beauvais addressed various gatherings of the profession, and Mr. King discussed with them the work of the C.I.C.A., stressing special projects and committee activities. In Regina, Vancouver, and Saskatoon Mr. Beauvais also presented certificates of admission to the successful candidates in the October 1951 examination. The host Institutes and Clubs arranged for a series of social functions in honour of the three visitors.

At Regina

Arriving at Regina on January 28, they were entertained at dinner at the Assiniboia Club by the president of the Saskatchewan Institute, Mr. H. S. Moffet, together with Mrs. Moffet and the other members of the Saskatchewan Institute Council and their wives. On January 29 the Regina Chartered Accountants Club held a luncheon meeting which was addressed by Mr. Beauvais and Mr. King.

At Calgary

On January 30 the Calgary chartered accountants held two functions: a luncheon given by Mr. A. G. Burton, president of the Alberta Institute, and the Calgary members of Council; and a dinner meeting of the Calgary Chartered Accountants Club.

At Edmonton

The next day Mr. and Mrs. Beauvais and Mr. King arrived in Edmonton and were entertained that evening at a reception given by Mr. and Mrs. Malcolm Tweddle. On the next day the Edmonton Chartered Accountants Club held a luncheon meeting in their honour.

At Vancouver

On February 3 the president of the British Columbia Institute, Mr. J. E. McIntosh, together with Mrs. McIntosh and the other members of the British Columbia Council and their wives, entertained at a reception for Mr. and Mrs. Beauvais and Mr. King. The next day Mr. Beauvais attended the Convocation exercises of the B.C. Institute held in Brock Hall at U.B.C. and presented the medals and prizes to prizewinners as well as certificates to the new members of the Institute. That evening he spoke at a dinner meeting held in the Vancouver Hotel.

At Saskatoon

On February 6 the group arrived at Saskatoon where they were guests at a dinner meeting of the Saskatoon Chartered Accountants Club. Following the meeting Mr. and Mrs. G. G. Patrick and Mr. and Mrs. C. P. DeRoche entertained in their honour.

At Winnipeg

In Winnipeg on February 7 Institute President William Young and Mrs. Young held a reception for them, which was attended by the members of Council and their wives. On February 8 there was a luncheon meeting at which Mr. Beauvais spoke and Mr. King discussed the work of the C.I.C.A.

ALBERTA

Mr. R. P. Alger, M.Com., C.A. announces the opening of an office for the practice of his profession at 405A Eighth Ave. W., Calgary.

BRITISH COLUMBIA

The Students Society of the B.C. Institute have elected the following officers and Council for their 1952 year: *president,* A. Murray; *vice-president,* B. Sproule; *secretary,* D. Porter; *treasurer,* B. Hunter; *Council*

members, R. Burrell, L. Manuel, Ian Adam, H. Karras. B. Fahy is chairman of the Education Committee and W. Parker of the Entertainment Committee.

* * *

Mr. S. E. Rickard, C.A. announces the admission to partnership of Mr. Peter W. Crawford, C.A. Henceforth practice of the profession will be carried on under the firm name of Rickard, Crawford & Co., Chartered Accountants, with offices at 850 W. Hastings St., Vancouver.

* * *

Helliwell, Maclachlan & Co., Chartered Accountants, announce the opening of a branch office at Vernon, B.C. with Mr. R. A. Stubbs, C.A. as resident manager.

NEW BRUNSWICK

Mr. Francis T. Smith, C.A. announces the opening of an office for the practice of his profession at 9 Victoria St., Campbellton.

ONTARIO

Chartered Accountants Club of Western Ontario

The Chartered Accountants Club of Western Ontario held their annual At Home at the Cobblestone Inn, near London, on Friday, February 29. Mr. J. A. Wilson, President of the Ontario Institute, and his wife were special guests. About 100 attended the party, which had been organized by Ross Morton, with the assistance of W. J. Carson. Prior to the At Home the special guests were entertained at the London Hunt and Country Club by G. A. MacDougall, president of the club.

Ontario Institute Annual Dinner

The Ontario Institute held its 69th annual dinner at the Royal York Hotel in Toronto on March 11. Mr. Max Freedman, Ottawa correspondent of the Winnipeg *Free Press*, was the guest of honour, and gave an exceptionally fine address on the subject of "Parliament, Past and Present". His Honour, the Lieutenant-Governor of Ontario, was a special guest. There were many representatives present from other accounting bodies, from the Government and from commercial organizations. Over 750 people attended the dinner, at which the prizes were presented to the various prize-winners. Mr. A. E. Beauvais, President of the Canadian Institute, made the presentation of the Canadian Institute Gold and Silver Medals to the prize-winners, both of whom were Ontario candidates.

Hamilton and District C.A. Association

The Hamilton and District Chartered Accountants' Association held a joint dinner meeting with the Hamilton Control of the Controllers' Institute of America, on March 13 in the Royal Connaught Hotel in Hamilton. Dr. K. W. Taylor, Assistant Deputy Minister, Department of Finance, Ottawa, gave a most interesting address on "The Preparation of the National Budget". He was introduced by Dr. G. P. Gilmour, President and Vice-Chancellor of McMaster University. Some 90 members and guests were present.

* * *

The Hamilton and District C.A. Association also gave $150 to the Hamilton Public Library for the purchase of books for their business section. The books had been recommended by the Association.

Another undertaking of the Association was its appointment of a committee of five members to visit the four collegiates in Hamilton, as well as McMaster University, in order to tell students about the profession of chartered accountancy. This committee also held a number of discussions with vocational guidance officers in the university and collegiates.

Chartered Accountants Club of Ottawa

The Chartered Accountants Club of Ottawa held a luncheon meeting on March 19 in the Quebec Suite of the Chateau Laurier. The guest speaker was Mr. A. Davidson Dunton, Chairman of the C.B.C.'s Board of Governors. He spoke on "Broadcasting in Canada".

The Chartered Accountants Club of Ottawa presented prizes to the top four who passed the last final examination, as follows: $25 to John Bennion, C.A.; $15 to Wm. K. Grundy, C.A.; $5 to John Cunliffe, C.A.; and $5 to Thomas Wood, C.A.

Windsor and District C.A. Association

Mr. Monteath Douglas, Executive Director

of the Canadian Tax Foundation, addressed a joint meeting of the Essex County Bar Association and the Windsor and District Chartered Accountants Association on March 24, 1952. He spoke on "The Background of the Forthcoming Budget". Mr. Hamish R. Macdonald, C.A. introduced the speaker and Mr. Keith M. Laird, Q.C. expressed the appreciation of the meeting.

* * *

Mr. J. Crandell, C.A. announces the opening of an office for the practice of his profession in the Norton Bldg., Georgetown.

* * *

Mr. Norman B. McLeod, C.A. announces the admission to partnership of Mr. David Armstrong, C.A. They will continue practice of their profession under the firm name of Norman B. McLeod & Co., Chartered Accountants, with offices in the Bank of Nova Scotia Bldg., Toronto.

QUEBEC

De Coster, Normandeau & Cie, comptables agréés, 80, rue St-Pierre, Québec, annonce qu'ils se sont associé à titre spécial, M. Donald Fortier, c.a.

Quebec Institute

Three prize winners were announced at the convocation ceremonies of the Quebec Institute at the Windsor Hotel on March 15, in which 130 successful candidates in the final examinations were presented to a large gathering of friends and relatives of the finalists and leaders in business and education. In his address Mr. G. M. Hawthorn, President of the Quebec Institute, called upon members of the profession to continue to take an active part in worthwhile causes and community affairs.

Four young women were among those who received certificates, bringing to 26 the number of women admitted by the Quebec Institute.

Medals and prizes were presented at the annual dinner which took place at the Windsor Hotel, Montreal, on Friday, April 4. The winners are:

Final examinations: Gold medal, James Hayes Yates, Montreal; second highest standing, cash prize, J. Roland Boilard, Quebec and Marcel Imbleau, Montreal, tied.

Intermediate examination: Silver medal, W. L. Letovsky and D. Léveillé, Montreal, tied; second highest standing, cash prize, E. Duby, Montreal.

Mr. Boilard also won the Students' Society cash prize for highest standing in auditing in the final examinations, and Mr. Léveillé the Students' Society cash prize for highest standing in auditing in the intermediate examination.

Quebec Students' Society

The Chartered Accountants Students' Society of Quebec held its last dinner meeting of the season at the Queen's Hotel on Tuesday evening, March 11, 1952. Mr. George C. McDonald, C.A., spoke on "The Widening Horizon of the C.A. Profession". The meeting was very well attended, with Russell G. Bremner, C.A., acting as chairman. Marcel Caron, C.A. introduced the speaker, and Pat Cassidy, C.A. thanked Mr. McDonald for his extremely interesting address.

News of Our Members

Rapid Grip and Batten Ltd. announce the appointment of Mr. D. R. Keedwell, C.A. (Ont.), as comptroller of the company.

* * *

Mr. Leopold Zinkewich, B.Com., C.A. (Que.), has been appointed comptroller of Young & Rubicam Ltd., Montreal.

Mr. J. N. Niblock, C.A. (Ont.), has been appointed secretary of the Dominion of Canada General Insurance Co., Toronto.

* * *

Mr. Harry Patriquin, C.A. (Alta.), has been elected president of the Maritime Provinces Association.

Obituaries

Harry Wilson

The Institute of Chartered Accountants of Quebec reports with sincere regret the death on January 28 of Harry Wilson in his 85th year.

Mr. Wilson became a member of the Quebec Institute in 1946 under the provisions of the Act regulating the practice of accountancy and auditing. He was formerly a member of the Institute of Accountants and Auditors, having been admitted after passing the final examination of that body in 1917, and had practised his profession from that date until he retired at the age of 83.

The members of the Institute extend their sincere sympathy to his family.

J. René Martin

The Institute of Chartered Accountants of Quebec reports with deep regret the untimely death of J. René Martin, age 35, who died at his home at Ste. Agathe des Monts on February 3, after a long illness.

After graduating from *l'Ecole des Hautes Etudes Commerciales,* Mr. Martin entered the firm of Mr. J. A. W. Archambault, C.A., and was admitted to membership on March 10, 1941. He later joined the staff of the Taxation Division of the Department of National Revenue in Montreal, and in 1945 opened an office at Ste. Agathe des Monts for the practice of his profession. He was president of the Ste. Agathe Board of Trade in 1947, and was a member of the Knights of Columbus and the Richelieu Club.

The members of the Institute extend their sincere sympathy to his widow and family in their sad bereavement.

SOME VALUABLE ACCOUNTING PUBLICATIONS

The American Institute of Accountants has just published four pamphlets containing the technical and professional papers presented at the Institute's last annual meeting, which Canadian accountants will find excellent and valuable reading. The pamphlets are respectively entitled "Financial Information Needed in Today's Mobilization Economy" (Price $1.00); "Five New Guides to the Auditor's Responsibility" (Price 75c); "Tax Problems Being Met in Today's Mobilization Economy" (Price $1.00); and "Public Relations and Legislative Control of the Accounting Profession" (Price 50c). All four pamphlets may be obtained for $3.00. Address orders to the American Institute of Accountants, Dept. AM, 270 Madison Ave., New York 16, N.Y.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

THE use of effective English is no easy matter and when we have raised the subject in the past we hope we have done so with appropriate humility. More than that, of course, we hope we may have been helpful in a modest way.

We have referred previously to Sir Ernest Gowers' *Plain Words.* Now, under the forbidding title of *Memorandum on The Drafting of Acts of Parliament and Subordinate Legislation* some further gems turn up — quite as unexpected as pearls in an oyster. The memorandum was prepared by Elmer A. Dreidger, K.C., Parliamentary Counsel, Department of Justice, Ottawa, October 1951. Naturally many of its suggestions are for a special purpose and are hardly relevant to accountancy. The point is, some of them *are* relevant to anyone interested in improving his English.

In his memorandum Mr. Dreidger recommends that compound verbs should not be split and illustrates his point as follows:

incorrect

"Where a person has
(a) filed a notice
(b) been served
(c) in his possession

correct

Where a person
(a) has filed
(b) has been served
(c) has in his possession."

As we read what the memorandum had to say about the passive voice we felt like crying "Bravo!" and almost threw the memorandum in the air in jubilation. How insipid, how contemptibly anonymous is the sentence that begins, *It is submitted that* . . . .; how much more direct, more virile, more likely to inspire confidence, is *I recommend that* . . .

In rather more restrained language than ours the author says, "The active voice should be preferred. Use of the passive form sometimes creates doubt as to what is intended. In 'notice shall be given' it is not clear who is to give the notice."

The memorandum touches upon the fear of using the same word twice in the same sentence, even when its repetition is needed for clarity. One should be careful, for example, about the use of qualifying words. In the phrase "any gross carelessness or neglect", does "gross" qualify "neglect"? If it does, the author recommends "any gross carelessness or gross neglect".

Speaking about the use of the words *such, said, the said, the same,* Mr. Driedger says, "These words are usually unnecessary and frequently create doubts. In most cases an article or pronoun can be used, with better effect."

Another point of general interest is the view that "Most of the *which's* in our statutes should be *that's;* a relative clause beginning with *which* is rarely needed. In

'An explosive *which* appears to the Minister to be abandoned . . . may be seized'

the *which* should be *that.*" (The author warns, though, that in a few places the choice of *which* or *that* may affect the meaning of a sentence.)

Finally, there is a little whimsy, too, in the memorandum:

"Definitions should not be too artificial. For example —

'dog' includes a cat

is asking too much of the reader;

'animal' means a dog or cat

would be better."

Dean Thompson

At the time of writing (which is somewhat in advance of the time this note will appear) we have learned with regret of the passing of Professor Joseph H. Thompson, Dean of Commerce, University of Saskatchewan. Those who knew him held him in high regard. Only last year he completed the *Canadian Supplement to Principles of Accounting, Introductory* (*H. A. Finney*).

[*A full obituary on the late Dean Thompson will appear in the June issue of The Canadian Chartered Accountant*]

CORRESPONDENCE

University of Alberta,
Edmonton, Alta.

Sir: I have read with interest your comments in the Students' Department appearing in the February, 1952, issue of *The Canadian Chartered Accountant.*

I regret that you have seen fit to disagree with "the very strong implication that funds are provided by depreciation". I admit that the mere provision for depreciation will not provide funds but on the assumption that the recording is seeking to disclose what has already occurred (a true and correct view) then the depreciation figure does represent some fact. What is it? May one be so rash as to suggest that it represents the estimate of the cost value of the fixed asset services transferred to customers during the period (assuming no closing inventory to complicate the question). In turn the customer has transferred reciprocal assets in the form of cash or promises to pay for the services in question. Is this not a source of working capital since the services were formerly of a nature to be classed as other than working capital? The objection that the amounts received may be more or less than the amount of depreciation due to inaccuracy of the estimation and profit or loss must be admitted. The subsequent statement which is made "the difficulty can be resolved by breaking the figure for income into its components and showing sales revenue as a source of funds and the various expenses (other than depreciation) as applications of working capital" seems to be a direct contradiction to the previous stand since depreciation here is stated by implication to be a source of funds.

"We are also in hearty agreement with the view that the statement should not be prepared from comparative balance sheets". I appreciate your desire for the detail of information rather than summarized data but I would also be interested in a factual demonstration of the preparation of a source and application of funds from the ledger accounts. I suspect the suggestion is that the preliminary steps in the preparation would be from the comparative balance sheet. The ledger accounts, when available, would be reviewed for significant detail behind the net figures which are revealed in the changes reflected by examination of the comparative balance sheets. The above quoted statement carries the implication that without the ledger accounts the statement prepared from the published statement data would be of little value. The published statements are prepared from the ledger accounts and reflect a combination or summarization of accounts with the detail eliminated which is considered unnecessary in presenting the financial position as at a given date. If the net changes do not mislead but are recognized as net changes the

error in complete presentation may not be as great as you suggest in respect to the source and application of funds statement.

As a fellow North American I also have sympathy for the "underdog".

J. D. CAMPBELL, C.A.

Editor's Reply: Your letter puts us on the defensive but we would naturally prefer to justify what we wrote than admit we were wrong.

But you do raise a difficult problem. We will go along with the theory that all costs are properly regarded as assets which are available for sale to customers and which, upon sale, will be realized (more or less) in the form of money or accounts receivable. Our view, however, is that the recording of costs has to be treated separately from their realization through sale. We think those are two separate and distinct types of transactions. The recovery of costs through sale to customers is not automatic. In fact, the whole accounting process is designed to show to what extent the recovery of costs (and perhaps something more) is achieved. We suggest you are treating the recording of costs and the recovery of costs as synonymous. Our impression is reinforced by your assumption, for purposes of argument, that there is no closing inventory "to complicate the question".

At any rate we are not yet convinced that to show revenue as a source of working capital, and expenses as an application, is to contradict the statement that depreciation is not a source of funds. We agree that revenue is a recovery (more or less) of costs. But it is a recovery of *all* kinds of costs and not just depreciation. If this is so, and we show revenue as a source of funds, why do we show *any* expense as an application of funds? We still think that the explanation is that cost amortization (e.g. depreciation) is the only possible type of expense the recording of which does not involve a reduction of working capital.

For us a large part of the justification of the funds statement must come from the possibility of its showing something *more* than the conventional financial statements, not merely a rearrangement of data already presented in a different form. We do not agree with your assumption that net changes do not mislead. And anyway we think the problem is not merely to avoid deceiving people but, in a positive way, to show all that is meaningful. The combination or summarization of ledger accounts reflected in the income statement and balance sheet is the combination or summarization that is appropriate for the preparation of those particular statements. We do not have any information about purchases and sales of fixed assets and long-term investments, or about the issue and redemption of bonds payable, because it is not the function of the balance sheet or income statement to disclose that information. Nevertheless we think it is always interesting and useful information and for us this is the role the funds statement should play.

PUZZLE FOR MAY

C is walking along a road towards a town. He has been told that half the people in the town are completely honest and the other half are complete liars. He reaches a fork in the road and there is no indication as to which fork is the correct one to the town. However, two citizens of the town, *A* and *B*, are standing at the fork. *C* does not know whether *A* is a liar or honest or whether *B* is a liar or honest. He is allowed to ask them one question each, requiring yes or no answers. From the answers he should be able to deduce the correct fork to take to the town.

What are the two questions *C* should ask, and what is the method he should use in deciding the correct fork?

(Contributed by W. R. Norman Campbell, Toronto.)

ANSWER TO PUZZLE FOR APRIL

526485
197485

723970

PROBLEMS AND SOLUTIONS

Qualified accountants have prepared the solutions appearing in this section, and the solutions reflect the personal views and opinions of their various contributors. Students should not regard them necessarily as models for submission to the examiner. The hope is rather that they will provide a basis for discussion and explanation of the problems such as will make their study beneficial. The editor will welcome discussion of the solutions published.

PROBLEM 1

Intermediate Examination, October 1951

Accounting I, Question 5 (15 marks)

The D Co. Ltd. with capital stock outstanding of 10,000 shares of $100 par value acquired, as of 31st December 1950, 4,000 common shares (par value $100 per share) at a cost of $125 per share in the P Co. Ltd. and all the shares (par value of $100 per share) of the N Co. Ltd. for $80 a share. The balance sheets of the three companies as at 31 Dec 1950 are shown below:

	D Co. Ltd.	P Co. Ltd.	N Co. Ltd.
Current assets	$500,000	$350,000	$ 50,000
Investment in P Co. Ltd.	500,000	....	....
Investment in N Co. Ltd.	80,000	....	....
Fixed assets	750,000	320,000	65,000
Goodwill	50,000	40,000	5,000
	$1,880,000	$710,000	$120,000
Current liabilities	$ 250,000	$160,000	$ 30,000
Capital stock outstanding	1,000,000	500,000	100,000
Surplus	630,000	50,000	....
Deficit	....	....	(10,000)
	$1,880,000	$710,000	$120,000

Required:

Consolidated balance sheet as at 31 Dec 1950.

A SOLUTION

D CO. LTD.

CONSOLIDATED BALANCE SHEET

as at 31st December 1950

Current assets	$ 900,000
Fixed assets	1,135,000
Goodwill on consolidation	145,000
	$2,180,000

Current liabilities	$ 440,000
Minority shareholders	110,000
Capital stock — 10,000 shares $100 par value	1,000,000
Surplus	630,000
	$2,180,000

CALCULATIONS

Minority Shareholders

P Co.		
Capital stock — 1,000 shares @ $100	$100,000	
Surplus 1/5 of $50,000	10,000	$ 110,000

Goodwill on Consolidation

P Co.				
Cost		$500,000		
Capital stock 4/5 of $500,000	$400,000			
Surplus 4/5 of 50,000	40,000	440,000	$ 60,000	
Goodwill on books of P Co.			40,000	$100,000
N Co.				
Cost — 1,000 shares @ $80 per share		$ 80,000		
Capital stock, 1,000 shares @ $100	$100,000			
Less deficit	10,000	90,000	(10,000)	
Goodwill on books			5,000	(5,000)
D Co.				
Goodwill on books				50,000
				$145,000

PROBLEM 2

Final Examination, October 1951

Accounting I, Question 1 (25 marks)

The S Manufacturing Co. Ltd. set up an accounting system whereby the cost information was to be recorded in the factory ledger, and all other data in the general ledger. The company manufactures two styles of mantle clock, and the standard cost sheets showed the following pre-determined costs:

	Material	Direct Labour	Factory Service Expense
Style No. 1	$30	$24	$12
Style No. 2	20	20	15

The accounting system requires that work-in-process accounts be carried at standard costs and that the material price variance be pro-rated to cost of goods sold and raw material inventory on the basis of materials put into production and retained in stores respectively. Variances, other than material price and factory service expense, have been transferred to the cost of goods sold account in the general ledger in arriving at the trial balance below. The proportion of material price variance which is assigned

to unused materials inventories is deferred. Factory service underabsorbed is to be charged to cost of goods sold each month.

For the month of July materials used, at standard prices, amounted to $6,400, and actual direct labour incurred amounted to $5,500.

The production record for the month of July was as follows:

	Style No. 1	Style No. 2
Units commenced	100	150
Units completed	90	130
Units on hand (finished stock) at 31 July	15	20
Units sold	75	110

There were no inventories on hand at the beginning of the month. At the end of the month all materials had been supplied for the work-in-process inventories but direct labour and factory service expense were only 65% completed.

The factory ledger, after the first month of operation, had the following trial balance as at 31st July:

	Dr.	Cr.
Finished goods	$ 2,090	
Material in process	700	
Labour in process	416	
Factory service expense in process	273	
Raw material inventory 31st July at standard	11,200	
Material price variance	220	
Factory service expense control	3,500	
Factory service expense applied		$ 3,303
General ledger control		15,096
	$18,399	$18,399

Required:

(20 marks) (a) Prepare the factory journal entries, complete with the detail of all calculations, for all material, labour, and factory service expense transactions for the month of July.

(5 marks) (b) Prepare a statement of cost of goods sold for the month of July.

A SOLUTION

THE S MANUFACTURING CO. LTD.

Factory Journal

(a)

	Dr.	Cr.
Raw material	$17,600	
Material price variance	220	
General ledger control		$17,820
To record purchase of raw material carried in raw material account at standard.		

	Dr.	Cr.
Raw material — work-in-process	6,000	
Material quantity variance	400	
Raw material		6,400
To charge to work-in-process at standard the raw material put into process during year.		

(Style 1 — 100 units at $30 = $3,000)
(Style 2 — 150 units at $20 = 3,000)

$6,000

Direct labour	5,500	
General ledger control		5,500
To record direct labour at standard prices.		

Direct labour — work-in-process	5,176	
Direct labour — variance	324	
Direct labour		5,500
To charge work in process at standard with the direct labour applied during the month.		

(Style 1 — 90 units at $24	$2,160)
(10 units at 65% of $24	156)
(Style 2 — 130 units at $20	2,600)
(20 units at 65% of $20	260)
	$5,176)

Factory service expense	3,500	
General ledger control		3,500
To record factory expense per factory ledger trial balance.		

Factory service expense applied — work-in-process	$ 3,303	
Factory service expense — variance	197	
Factory service expense		$ 3,500
To charge work-in-process with factory service expense applied.		

(Style 1 — 90 units @ $12	$1,080)
(10 units @ 65% of $12	78)
(Style 2 — 130 units @ $15	1,950)
(20 units @ 65% of $15	195)
	$3,303

Finished goods Style 1	$ 5,940	
Finished goods Style 2	7,150	
Work-in-process — raw material		5,300
— direct labour		4,760
— factory service		3,030
To transfer to finished goods the units completed during the year.		

(Style 1 — 90 units @ $30 material	$2,700)
(90 units @ $24 labour	2,160)
(90 units @ $12	
(factory service	1,080)
	$5,940

Style 2 — 130 units @ $20 material	$2,600		
130 units @ $20 labour	2,600		
130 units @ $15 factory service	1,950		
	$7,150		

General ledger control		$11,000	
Finished goods Style 1			4,950
Finished goods Style 2			6,050
To transfer to cost of goods sold the cost of units sold.			
Style 1 — 75 units @ $66	$4,950		
2 — 110 units @ $55	6,050		
	$11,000		

General ledger control		1,001	
Material quantity variance			400
Direct labour variance			324
Factory service variance			197
Material price variance			80
To charge cost of goods sold with variances applicable to production and a proportion of material price variance.			
Material used in production	$6,400		
Price variance applicable $6,400 x $220 = $80 / 17,600			

(b) THE S MANUFACTURING CO. LTD.

STATEMENT OF COST OF GOODS SOLD
for the month of July

Manufacturing costs:	
Raw material	$ 6,000
Direct labour	5,176
Factory service expense	3,303
	$14,479

Less inventory work-in-process 31st July			1,389
Material — 10 units @ $30	$300		
— 20 units at $20	400	$700	
Labour — 10 units @ 65% of $24	156		
— 20 units @ 65% of $20	260	416	
Factory service			
— 10 units @ 65% of $12	78		
— 20 units @ 65% of $15	195	273	
		1,389	
Cost of production			13,090
Less inventory of finished goods 31st July			2,090
15 units @ $66	$ 990		
20 units @ $55	1,100	$2,090	
*Cost of goods sold at standard			$11,000
Add variances over standard			
Labour		$ 324	
Factory service		197	
Material quantity		400	
Material price		80	1,001
Cost of goods sold			$12,001

*OR

Cost of goods sold at standard		
75 units of # 1 @ $66	$4,950	
110 units of # 2 @ $55	6,050	$11,000

PROBLEM 3

Final Examination, October 1951

Accounting I, Question 2 (15 marks)

X, manufacturer of product Y, which is produced by a series of continuous processes, asks CA's advice concerning the installation of a cost system.

To date his accounting system is designed for the purpose of preparing annual balance sheets and manufacturing, trading, and profit and loss statements. Inventories of work-in-process and finished goods are estimated.

Since competition has become very keen and the margin of profit is low, X would like to have his records reflect for each process the costs, the monthly production, and the quantity and value of inventory in process at the end of each month.

Required:

(5 marks) (a) What general additions or alterations would be necessary to the present accounting system?

(10 marks) (b) In the operation of the cost system, how would the following items be classified and distributed to processes:

(i) Depreciation of machinery.

(ii) Supplies used in manufacturing.
(iii) Raw materials purchased.
(iv) Wages of factory workers.
(v) Salary of plant superintendent.
(vi) Salary of sales manager.
(vii) Cost of operating electrical power plant which services entire factory.

A SOLUTION

(a) X

Recommended Additions or Alterations to Present Accounting System

(1) Subsidiary cost records must be established.
(2) The subsidiary cost ledger control account is set up in the general ledger.
(3) All material, labour and factory service put into production is charged in the general ledger to Subsidiary cost ledger control account rather than to an expense account.
(4) Subsidiary cost records must be separated as to processes.
(5) All charges to subsidiary costs must be classified and charged to the applicable process in the subsidiary cost records.
(6) Transfers from one process to another in subsidiary cost records will be made as goods completely processed in one department are passed on to the next process. (This has no effect on the general ledger.)
(7) Inventories of raw materials and finished goods may be carried in either the general or the subsidiary ledger, whereas inventories of work-in-process will be picked up from the subsidiary cost records.
(8) Production orders properly authorized will control the flow of production between processes.

(b) X — COST SYSTEM

Classification of Costs and Distribution to Processes

	Classification	Distribution
(i) Depreciation on machinery	Factory expense	On basis of process in which the machine is used.
(ii) Manufacturing supplies	Factory expense	Charge to process using the supplies or, if general, distribute on basis of labour or some other yardstick.
(iii) Raw materials	Inventory	To process as used.
(iv) Wages of factory workers	Direct labour	Charge direct to process using the labour.
(v) Salary of plant superintendent	Factory administration expense	Distribute on basis of direct labour to processes.
(vi) Salary of sales manager	Selling expense	Selling expense is not distributed to production.
(vii) Electrical power plant cost	Factory expense	Distribute to processes on basis of Kwt. used.